

General Information Letter: Public Law 86-272 applies to sellers of tangible personal property, which includes "canned" software.

October 7, 1998

Dear:

This is in response to your letter dated September 28, 1998 in which you request a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding upon the Department. See Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

I am writing to request a General Information Letter in regards to whether a client has income tax nexus in Illinois. This client, which I will call XYZ, was filing income tax returns in Illinois until 1986, when it formally withdrew from Illinois. XYZ withdrew from Illinois because it closed its only office in the state. XYZ continues to be registered for sales and use tax purposes.

XYZ is engaged in the manufacture of software (in a state other than Illinois), and sells such software into a number of states, including Illinois. XYZ has no physical location or ownership of property in Illinois, and provides no services in the state other than occasional solicitation activities (which are protected under Public Law 86-272). The sale of the software, which is canned software, is actually the sale of a license to use the software in the state. The issue is thus whether the mere sale of software in Illinois, which has been construed in some states as intangible property, creates income tax nexus for the seller of the software. If the answer is yes, is the voluntary disclosure program available to XYZ, even though the company filed income tax returns in Illinois through 1986?

### Ruling

Public Law 86-272 precludes a state from imposing a net income tax against a person whose only contacts with the state consist of the solicitation of orders for sales of tangible personal property (See 15 U.S.C. 381). Public Law 86-272 does not define the term "sales" nor what property shall be considered "tangible personal property."

Nevertheless, Treasury Regulations §1.861-18(f) sets forth rules for determining whether transfers of computer programs should be regarded as sales or as merely licenses or leases. These rules apply regardless of any label attached to the transfer by the transacting parties. In addition, in Illinois canned computer software, as distinguished from custom-made or modified software, is considered tangible personal property (See 35 ILCS 120/2-35).

Your letter states that XYZ, whose only contact with Illinois involves solicitation activities protected under Public Law 86-272, licenses the use of canned computer software to customers in Illinois. Therefore, provided such licenses constitute sales under Treasury Regulations §1.861-18(f) and XYZ is otherwise protected by Public Law 86-272, income derived by it from the transfer of canned software in Illinois will not be subject to Illinois income tax.

As stated above, this is a GIL that does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding upon the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.102.

Sincerely,

Brian L. Stocker  
Staff Attorney - Income tax